Third Circuit Court of Appeals Approves Use of Short-Term Annuities in Medicaid Planning

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On September 2, 2015, the Third Circuit Court of Appeals handed down a decision concerning immediate annuities that will make it easier for seniors, especially those who are single and have limited assets, to protect half or more of their life savings if they need long-term nursing care.[1]

Immediate annuities are an important tool used by elder law attorneys to help their clients in two basic ways:

- First, an individual in a nursing home can buy an annuity to provide income to pay the nursing home while waiting out the period of ineligibility created by gifts made within the previous five years. Often, these annuities are of relatively short duration – only as long as the ineligibility period.
- Second, many spouses of nursing-home residents face a dramatic reduction in income when the nursing-home spouse qualifies for Medicaid. Immediate annuities work by converting countable assets that would otherwise have to be paid to the nursing home into a non-countable income stream for the healthy spouse. Purchasing an immediate annuity that meets all of the legal requirements under the Medicaid law can give the community spouse greater financial security while greatly accelerating Medicaid eligibility for the spouse in the nursing home.

But some states, including Pennsylvania, have maintained that short-term annuities – usually those for two years or less – are still subject to a transfer penalty. This should change now that the Third Circuit Court of Appeals has ruled that these types of annuities – if they meet all of the statutory requirements – cannot be counted as resources or be made subject to a transfer penalty for Medicaid eligibility purposes.

In *Zahner v. Secretary, Pa. Dept. of Human Services* (3rd Cir., Nos. 14-1328, 14-1406, Sept. 2, 2015), the Third Circuit upheld the use of short-term annuities as a permissible Medicaid planning strategy. The plaintiffs in this case were three elderly women (and clients of mine) who needed long-term nursing care. We had them gift part of their savings to their adult children and use the balance to purchase short-term

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[1] This is the 5th straight victory for Pennsylvania elder law attorneys against the Pennsylvania Medicaid Agency. The earlier cases dealt with the State's attempts to stop the use of spousal annuities – *Mertz v. Houstoun*, 155 F. Supp. 2d 415, 428 (E.D. Pa. 2001); *James v. Richman*, 547 F.3e 214 (3rd Cir. 2008); *Weatherbee v. Richman*, 351 Fed. App'x 786, 787 (3d Cir. 2009) – or to hamstring the use of pooled special needs trusts, *Lewis v. Alexander*, 685 F.3d 325 (3rd Cir. 2012), *cert. denied,* 184 L.Ed.2d 724 (2013).

annuities to cover the cost of their nursing-home care during the period of ineligibility created by their gifts.

The Pennsylvania Medicaid Agency (the Department of Human Services or DHS) treated the purchase of these annuities as "gifts" because each annuity had a payment term shorter than two years (one was for 18 months, one for 14 months, and one for 12 months). As a result, each of the plaintiffs was assessed with an additional period of ineligibility for Medicaid based on her annuity purchase, which greatly reduced the amount of assets that each could protect. DHS also argued that these annuities were "sham transactions" with no economic value other than to qualify the applicants for Medicaid and therefore should be penalized.

At the trial level the federal district court in Erie ruled in favor of the state. The judge's opinion stated that while each of the plaintiffs' annuities met all of the specific requirements in the Medicaid statute for their purchase not to be treated as a gift, the annuity payment terms were too short to pass the "sniff test" – their only purpose was to accelerate the plaintiffs' Medicaid eligibility while protecting part of the plaintiffs' assets and therefore they should be penalized.

On appeal the Third Circuit reversed the district court's decision, finding that:

- While the Medicaid law creates an upper limit for annuity terms, it does not impose any floor or minimum term, and therefore the purchase of these annuities should not have been treated as gifts with penalty periods imposed.

- The purpose for which these annuities were purchased – to accelerate the plaintiffs' Medicaid eligibility while protecting part of their life savings – is irrelevant; there is no "sniff test" in the Medicaid law. As long as short-term annuities meet the safe-harbor requirements that Congress has put into the statute, they are a permissible tool for asset protection planning.

The court also noted the ironic practical effect of following the State's policy of disallowing annuities with terms shorter than two years: it would have no effect on seniors with $400,000 or more of savings, who could continue protecting at least half of assets from having to be spent on their nursing care; but the State's policy would make it difficult for seniors with less than $400,000 of assets (which would include the great majority of the families who come in to see us for asset-protection planning) to protect anything. In other words, the Pennsylvania policy would hit hardest those seniors with modest assets, the very people the Medicaid laws were intended to protect. [2]

How Does the *Zahner* Decision Help Seniors in Pennsylvania?

[2] The Third Circuit opinion pointed out in a footnote that the lower court failed to recognize countervailing policy considerations that weigh in favor of short-term annuities. "Shorter annuities make it possible for people with fewer assets to purchase annuities. Being able to purchase an annuity for multiple years requires a large upfront cost that aging, low-income individuals may not have access to."

- Single Medicaid Applicants: As noted above, the seniors who will benefit most from the *Zahner* decision are those who are *single* and who *have less than $400,000 of savings*. If they need to apply for long-term care Medicaid – either in a nursing home or at home – the court has confirmed that they can use short-term annuities in connection with gifting to protect at least half of their life savings from having to be spent down on their nursing care. This strategy is particularly important because it can be used in a crisis, that is, when the senior is already in a nursing home and has not done any advance planning.

- Married Couples: This ruling by the Third Circuit also benefits married couples by confirming the use of annuities with payment terms shorter than two years. Generally spousal annuities – that is, those payable to the spouse living at home (the "community spouse") – are used in cases that do not involve gifting with the annuities that pay the money back over a short period of time, and so spousal annuities typically have payment terms of three years or more. But in the right circumstances (such as an elderly or ill community spouse with a short life expectancy, whose monthly income will not be inordinately large when the annuity payment is included), shorter-term annuities can be helpful for a married couple as well.

So the Zahner decision is a major victory for seniors in the Third Circuit (Pennsylvania, New Jersey, Delaware, and the Virgin Islands) and certainly helpful for seniors across the country. But while the Third Circuit's decision provides clear guidance to both seniors and Medicaid agencies, immediate annuities must still meet a number of strict requirements to be accepted as legitimate by the Medicaid authorities. It is therefore important that families considering them get help from a qualified elder law attorney.

Note: *With the restrictions in the Deficit Reduction Act that came into effect in 2006, it is more true than ever that "time works against you" when planning for long-term care. It is important that families who have a spouse, parent or other loved one needing long-term nursing care contact a knowledgeable and experienced elder law attorney for advice as soon as possible. While ideally this should be done when there is at least five years before such care will be needed, families need to realize* that even with the new restrictions in the DRA, there remain opportunities for seniors to protect a significant portion of their life savings when facing an immediate crisis, with no advance planning. *But every day of delay represents a potential $220 or more of irretrievable loss, so seek advice sooner rather than later.*

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